



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72336; File No. SR-NYSEArca-2014-42)

June 5, 2014

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Granting Approval of Proposed Rule Change Relating to the Listing and Trading of Shares of Schwab Active Short Duration Income ETF; Schwab TargetDuration 2-Month ETF; Schwab TargetDuration 9-Month ETF; and Schwab TargetDuration 12-Month ETF under NYSEArca Equities Rule 8.600

I. Introduction

On April 14, 2014, NYSE Arca, Inc. (“Exchange” or “NYSE Arca”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade shares (“Shares”) of the Schwab Active Short Duration Income ETF; Schwab TargetDuration 2-Month ETF; Schwab TargetDuration 9-Month ETF; and Schwab TargetDuration 12-Month ETF (individually, “Fund,” and collectively, “Funds”) under NYSE Arca Equities Rule 8.600. The proposed rule change was published for comment in the Federal Register on May 1, 2014.³ The Commission received no comments on the proposed rule change. This order grants approval of the proposed rule change.

II. Description of the Proposed Rule Change

The Exchange proposes to list and trade Shares of the Funds pursuant to NYSE Arca Equities Rule 8.600, which governs the listing and trading of Managed Fund Shares on the Exchange. Each Fund is a series of the Schwab Strategic Trust (“Trust”), a statutory trust organized under the laws of the State of Delaware and registered with the Commission as an

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 72028 (Apr. 25, 2014), 79 FR 24789 (“Notice”).

open-end management investment company.⁴ The Funds will be advised by Charles Schwab Investment Management, Inc. (“CSIM” or “Adviser”). The Exchange states that the Adviser is not a broker-dealer but is affiliated with a broker-dealer, Charles Schwab & Co., Inc. The Adviser has implemented and will maintain a fire wall with respect to its broker-dealer affiliate regarding access to information concerning the composition of or changes to each respective Fund’s portfolio.⁵

The Exchange has made the following representations and statements in describing the Funds and their respective investment strategies, including other portfolio holdings and investment restrictions.

⁴ The Trust is registered under the Investment Company Act of 1940 (“1940 Act”). According to the Exchange, on November 21, 2012, the Trust filed with the Commission a registration statement on Form N-1A under the Securities Act of 1933 (“Securities Act”) and the 1940 Act relating to the Schwab Active Short Duration Income ETF (File Nos. 333-160595 and 811-22311) (“Short Duration Registration Statement”). On August 1, 2013, the Trust filed with the Commission a registration statement on Form N-1A under the Securities Act and the 1940 Act for the Schwab TargetDuration 2-Month ETF; Schwab TargetDuration 9-Month ETF; and Schwab TargetDuration 12-Month ETF (File Nos. 333-160595 and 811-22311) (“TargetDuration Registration Statement” and, together with the Short Duration Registration Statement, collectively, “Registration Statements”). In addition, the Exchange states that the Adviser (defined herein) has obtained certain exemptive relief under the 1940 Act. See Investment Company Act Release No. 30606 (July 23, 2013) (File No. 812-14009). The Exchange states that each Fund will be offered in reliance upon the Exemptive Order issued to the Adviser.

⁵ See NYSE Arca Equities Rule 8.600, Commentary .06. In the event (a) the Adviser becomes a registered broker-dealer or newly affiliated with a broker-dealer, or (b) any new adviser or sub-adviser is a registered broker-dealer or becomes affiliated with a broker-dealer, the adviser or sub-adviser will implement a fire wall with respect to its relevant personnel or its broker-dealer affiliate regarding access to information concerning the composition of or changes to the portfolios, and it will be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding the portfolios.

Schwab Active Short Duration Income ETF⁶

Principal Investments

According to the Short Duration Registration Statement, the investment objective of the Fund is to seek a high level of current income consistent with preservation of capital and daily liquidity.

To pursue its goal, it is the Fund's policy, under normal circumstances,⁷ to invest at least 90% of its net assets⁸ in a portfolio of investment-grade short-term fixed-income securities issued by U.S. and foreign issuers and in other short-term investments, as described below. The short-term fixed-income securities in which the Fund may invest include corporate and commercial debt instruments;⁹ privately-issued securities;¹⁰ mortgage-backed and asset-backed

⁶ The Adviser represents that the name of this Fund will be changed to the Schwab TargetDuration 6-Month ETF prior to commencement of listing and trading of Shares of the Fund on the Exchange. This change will be reflected in an amendment to the Short Duration Registration Statement.

⁷ With respect to each of the Funds, the term "under normal circumstances" includes, but is not limited to, the absence of extreme volatility or trading halts in the fixed-income markets or the financial markets generally; events or circumstances causing a disruption in market liquidity or orderly markets; operational issues causing dissemination of inaccurate market information; or force majeure type events such as systems failure, natural or man-made disaster, act of God, armed conflict, act of terrorism, riot or labor disruption, or any similar intervening circumstance.

⁸ Each Fund's 90% investment policy may be satisfied by the investments outlined in a Fund's "Principal Investments" section. Certain "Non-Principal Investments" of each Fund, as discussed below, may also be considered within a Fund's 90% investment policy to the extent they are investment-grade short-term fixed-income securities. See note 55, *infra*.

⁹ The Adviser expects that, under normal market circumstances, each Fund will generally seek to invest in corporate bond issuances in developed countries that have at least \$100,000,000 par amount outstanding and at least \$200,000,000 par amount outstanding with respect to corporate bond issuances in emerging market countries.

¹⁰ Privately-issued securities are generally issued under Rule 144A of the Securities Act.

securities;¹¹ variable- and floating-rate fixed-income securities; repurchase agreements;¹² money market instruments, including, but not limited to certificates of deposit, commercial paper, promissory notes, and asset-backed commercial paper; obligations issued by the U.S. government or its agencies and instrumentalities, including but not limited to, obligations that are not guaranteed by the U.S. Treasury, such as those issued by Fannie Mae and Freddie Mac; and bank notes and similar demand deposits. To gain exposure to short-term fixed-income securities, the Fund may invest in other short-term investments including (1) money market funds (including funds that are managed by the Adviser or one of its affiliates), (2) other investment

¹¹ Each Fund's investments in each of the following security types will be limited to 10% of a Fund's net assets: (1) non-agency residential-mortgage-backed securities; (2) non-agency commercial-mortgage-backed securities; and (3) non-agency asset-backed securities. Each Fund's aggregate investments in the following security types will be limited to 20% of a Fund's net assets: (1) non-agency residential-mortgage-backed securities; (2) non-agency commercial-mortgage-backed securities; and (3) non-agency asset-backed securities. As noted for each Fund, at least 90% of a Fund's net assets will be, under normal circumstances, invested in U.S. dollar-denominated fixed-income securities. All fixed-income securities, including mortgage-backed and asset-backed securities, purchased by a Fund will be rated A- or higher. Neither high-yield asset-backed securities nor high-yield mortgage-backed securities are included in a Fund's principal investment strategies. The liquidity of a security, especially in the case of asset-backed and mortgage-backed debt securities, is a factor in each Fund's security selection process. Asset-backed securities backed by a specific industry receivable are classified into distinct industries based on the underlying credit and liquidity structures. Asset-backed commercial paper programs backed by multiple industry receivables are classified within a multi-industry category. Each Fund will limit investments in each identified industry individually and in the multi-industry category to less than 25% of its net assets.

¹² Repurchase agreements are instruments under which a buyer acquires ownership of certain securities (usually U.S. government securities) from a seller who agrees to repurchase the securities at a mutually agreed-upon time and price, thereby determining the yield during the buyer's holding period. The period to maturity for repurchase agreements is generally short (from overnight to one week), although it may be longer. In addition, the securities collateralizing a repurchase agreement may have longer maturity periods.

companies,¹³ including exchange-traded funds (“ETFs”),¹⁴ that invest in securities similar to those in which the Fund may invest directly, and (3) cash and cash equivalents. All of these investments will be denominated in U.S. dollars, including those that are issued by foreign issuers.

All fixed-income securities purchased by the Fund will be rated A- or higher by Standard & Poor’s Corporation (“S&P”); will have an equivalent rating by another Nationally Recognized Statistical Rating Organization (“NRSRO”), such as Fitch Inc. (“Fitch”) or Moody’s Investor Services, Inc. (“Moody’s”); or, if unrated, will be of equivalent quality, as determined by the Adviser.¹⁵

Under normal circumstances, the Fund will generally maintain a portfolio duration of less than six months.¹⁶ The Adviser may adjust the Fund’s duration within the stated limit based on current or anticipated changes in interest rates.

¹³ Each Fund may invest in other investment companies to the extent permitted by Section 12(d)(1) of the 1940 Act and rules thereunder or by any applicable exemption under the 1940 Act with respect to such investments.

¹⁴ For purposes of this proposed rule change, ETFs include Investment Company Units (as described in NYSE Arca Equities Rule 5.2(j)(3)); Portfolio Depositary Receipts (as described in NYSE Arca Equities Rule 8.100); and Managed Fund Shares (as described in NYSE Arca Equities Rule 8.600). The ETFs all will be listed and traded in the U.S. on registered exchanges. While each Fund may invest in inverse ETFs, a Fund will not invest in leveraged (e.g., 2X or 3X) or leveraged inverse ETFs.

¹⁵ In determining whether a security is of “equivalent quality,” the Adviser may consider various factors, including but not limited to: whether the issuer of the security has issued other rated securities; whether the obligations under the security are guaranteed by another entity and the rating of the guarantor (if any); whether and (if applicable) how the security is collateralized; other forms of credit enhancement (if any); the security’s maturity date; liquidity features (if any); relevant cash flow(s); valuation features; and other structural analysis.

¹⁶ Duration measures the price sensitivity of a security to interest rate changes. The longer the duration, the more sensitive the portfolio will be to a change in interest rates.

Additionally, under normal circumstances, the Fund generally expects to maintain a portfolio maturity (which is the weighted average maturity of all the securities held in the portfolio) of less than twelve months (1 year). For most security types, the security's final maturity date (the date on which the final principal payment of the security is scheduled to be paid) will be used to determine the Fund's portfolio maturity.¹⁷ The Fund will not purchase any security with a maturity – or, for securitized investments, a weighted average life – of more than twenty-four months (2 years) from the date of acquisition. The Adviser may adjust the Fund's maturity within the stated limit based on current and anticipated changes in interest rates.

The Fund is an actively-managed fund that does not seek to track the performance of a specific index. The Exchange notes, however, that the Fund's portfolio, under normal circumstances, will meet certain criteria similar to those applicable to index-based, fixed-income exchange-traded funds contained in NYSE Arca Equities Rule 5.2(j)(3), Commentary.02.¹⁸

¹⁷ For securitized investments such as asset-backed and mortgage-backed securities, the security's weighted average life (the weighted average time to receipt of all principal payments) will be used to determine a Fund's portfolio maturity, while for securities with embedded demand features, such as puts or calls, either the security's demand date or the final maturity date, depending on interest rates, yields, and other market conditions, will be used.

¹⁸ See NYSE Arca Equities Rule 5.2(j)(3), Commentary .02 governing fixed-income based Investment Company Units. Under normal circumstances, each Fund's portfolio will meet the following criteria: (i) components that in the aggregate account for at least 65% of the weight of the index or portfolio must each have a minimum original principal amount outstanding of \$100 million or more (in contrast to the requirement in NYSE Arca Equities Rule 5.2(j)(3), Commentary .02(a)(3) that 75% of the weight of the index or portfolio meet such requirement); (ii) no component fixed-income security (excluding Treasury Securities, government-sponsored entity and other exempted securities) will represent more than 30% of the weight of the portfolio, and the five highest-weighted component fixed-income securities (excluding Treasury Securities, government-sponsored entity and other exempted securities) will not in the aggregate account for more than 65% of the weight of the portfolio; and (iii) the portfolio (excluding Treasury Securities, government-sponsored-entity securities and other exempted securities) will include securities from a minimum of 13 non-affiliated issuers. Each Fund will not be required to meet the requirements of NYSE Arca Equities Rule 5.2(j)(3), Commentary

Schwab TargetDuration 2-Month ETF

Principal Investments

According to the TargetDuration Registration Statement, the investment objective of the Fund is to seek current income consistent with preservation of capital and daily liquidity.

To pursue its goal, it is the Fund's policy, under normal circumstances,¹⁹ to invest at least 90% of its net assets²⁰ in a portfolio of investment-grade short-term fixed-income securities issued by U.S. and foreign issuers and in other short-term investments. The fixed-income securities in which the Fund may invest include corporate and commercial debt instruments;²¹ privately-issued securities;²² mortgage-backed and asset-backed securities;²³ variable- and floating-rate fixed-income securities; repurchase agreements;²⁴ money market instruments, including, but not limited to certificates of deposit, commercial paper, promissory notes, and asset-backed commercial paper; obligations issued by the U.S. government or its agencies and instrumentalities, including but not limited to, obligations that are not guaranteed by the U.S. Treasury, such as those issued by Fannie Mae and Freddie Mac; and bank notes and similar demand deposits. To gain exposure to short-term fixed-income securities, the Fund may invest in other short-term investments including (1) money market funds (including funds that are

.02(a)(3) (which relates to convertible security index components and removal of such components from an index or portfolio once the convertible security converts to the underlying security), and Commentary .02(a)(6) (which relates to reporting, numerical, or other enumerated requirements applicable to issuers of index component securities).

¹⁹ See note 7, supra.

²⁰ See note 8, supra.

²¹ See note 9, supra.

²² See note 10, supra.

²³ See note 11, supra.

²⁴ See note 12, supra.

managed by the Adviser or one of its affiliates), (2) other investment companies,²⁵ including ETFs,²⁶ that invest in securities similar to those in which the Fund may invest directly, and (3) cash and cash equivalents. All of these investments will be denominated in U.S. dollars, including those that are issued by foreign issuers.

All fixed-income securities purchased by the Fund will be rated A- or higher by S&P; hold an equivalent rating by another NRSRO such as Fitch or Moody's; or, if unrated, be determined by the Adviser to be of equivalent quality.²⁷

Under normal circumstances, the Fund will generally maintain a portfolio duration of less than two months.²⁸ The Adviser may adjust the Fund's duration within the stated limit based on current and anticipated changes in interest rates.

Additionally, under normal circumstances, the Fund generally expects to maintain a portfolio maturity (which is the weighted average maturity of all the securities held in the portfolio) of less than four months. For most security types, the security's final maturity date (the date on which the final principal payment of the security is scheduled to be paid) will be used to determine the Fund's portfolio maturity.²⁹ The Fund will not purchase any security with a maturity – or, for securitized investments, a weighted average life – of more than eighteen months (1.5 years) from the date of acquisition. The Adviser may adjust the Fund's maturity within the stated limit based on current and anticipated changes in interest rates.

²⁵ See note 13, supra.

²⁶ See note 14, supra.

²⁷ See note 15, supra.

²⁸ See note 16, supra.

²⁹ See note 17, supra.

The Fund is an actively-managed fund that does not seek to track the performance of a specific index. The Exchange notes, however, that the Fund's portfolio, under normal circumstances, will meet certain criteria similar to those applicable to index-based, fixed-income exchange-traded funds contained in NYSE Arca Equities Rule 5.2(j)(3), Commentary .02.³⁰

Schwab TargetDuration 9-Month ETF

Principal Investments

According to the TargetDuration Registration Statement, the investment objective of the Fund is to seek a high level of current income consistent with preservation of capital.

To pursue its goal, it is the Fund's policy, under normal circumstances,³¹ to invest at least 90% of its net assets³² in a portfolio of investment-grade short-term fixed-income securities issued by U.S. and foreign issuers and in other short-term investments. The fixed-income securities in which the Fund may invest include corporate and commercial debt instruments;³³ privately-issued securities³⁴; mortgage-backed and asset-backed securities;³⁵ variable- and floating-rate fixed-income securities; repurchase agreements,³⁶ money market instruments, including, but not limited to certificates of deposit, commercial paper, promissory notes, and asset-backed commercial paper; obligations issued by the U.S. government or its agencies and instrumentalities, including but not limited to, obligations that are not guaranteed by the U.S. Treasury, such as those issued by Fannie Mae and Freddie Mac; and bank notes and similar

³⁰ See note 18, supra.

³¹ See note 7, supra.

³² See note 8, supra.

³³ See note 9, supra.

³⁴ See note 10, supra.

³⁵ See note 11, supra.

³⁶ See note 12, supra.

demand deposits. To gain exposure to short-term fixed-income securities, the Fund may invest in other short-term investments including (1) money market funds (including funds that are managed by the Adviser or one of its affiliates), (2) other investment companies,³⁷ including ETFs,³⁸ that invest in securities similar to those in which the Fund may invest directly, and (3) cash and cash equivalents. All of these investments will be denominated in U.S. dollars, including those that are issued by foreign issuers.

All fixed-income securities purchased by the Fund will be rated A- or higher by S&P; hold an equivalent rating by another NRSRO such as Fitch or Moody's; or, if unrated, be determined by the Adviser to be of equivalent quality.³⁹

Under normal circumstances, the Fund will generally maintain a portfolio duration of less than nine months.⁴⁰ The Adviser may adjust the Fund's duration within the stated limit based on current and anticipated changes in interest rates.

Additionally, under normal circumstances, the Fund generally expects to maintain a portfolio maturity (which is the weighted average maturity of all the securities held in the portfolio) of less than eighteen months (1.5 years). For most security types, the security's final maturity date (the date on which the final principal payment of the security is scheduled to be paid) will be used to determine the Fund's portfolio maturity.⁴¹ The Fund will not purchase any security with a maturity – or, for securitized investments, a weighted average life – of more than

³⁷ See note 13, supra.

³⁸ See note 14, supra.

³⁹ See note 15, supra.

⁴⁰ See note 16, supra.

⁴¹ See note 17, supra.

thirty months (2.5 years) from the date of acquisition. The Adviser may adjust the Fund's maturity within the stated limit based on current and anticipated changes in interest rates.

The Fund is an actively-managed fund that does not seek to track the performance of a specific index. The Exchange notes, however, that the Fund's portfolio, under normal circumstances, will meet certain criteria similar to those applicable to index-based, fixed-income exchange-traded funds contained in NYSE Arca Equities Rule 5.2(j)(3), Commentary .02.⁴²

Schwab TargetDuration 12-Month ETF

Principal Investments

According to the TargetDuration Registration Statement, the investment objective of the Fund is to seek maximum current income consistent with preservation of capital.

To pursue its goal, it is the Fund's policy, under normal circumstances,⁴³ to invest at least 90% of its net assets⁴⁴ in a portfolio of investment-grade short-term fixed-income securities issued by U.S. and foreign issuers and in other short-term investments. The fixed-income securities in which the Fund may invest include corporate and commercial debt instruments;⁴⁵ privately-issued securities;⁴⁶ mortgage-backed and asset-backed securities;⁴⁷ variable- and floating-rate fixed-income securities; repurchase agreements;⁴⁸ money market instruments, including, but not limited to certificates of deposit, commercial paper, promissory notes, and asset-backed commercial paper; obligations issued by the U.S. government or its agencies and

⁴² See note 18, supra.

⁴³ See note 7, supra.

⁴⁴ See note 8, supra.

⁴⁵ See note 9, supra.

⁴⁶ See note 10, supra.

⁴⁷ See note 11, supra.

⁴⁸ See note 12, supra.

instrumentalities, including but not limited to, obligations that are not guaranteed by the U.S. Treasury, such as those issued by Fannie Mae and Freddie Mac; and bank notes and similar demand deposits. To gain exposure to short-term fixed-income securities, the Fund may invest in other short-term investments including (1) money market funds (including funds that are managed by the Adviser or one of its affiliates), (2) other investment companies,⁴⁹ including ETFs,⁵⁰ that invest in securities similar to those in which the Fund may invest directly, and (3) cash and cash equivalents. All of these investments will be denominated in U.S. dollars, including those that are issued by foreign issuers.

All fixed-income securities purchased by the Fund will be rated A- or higher by S&P; hold an equivalent rating by another NRSRO such as Fitch or Moody's; or, if unrated, be determined by the Adviser to be of equivalent quality.⁵¹

Under normal circumstances, the Fund will generally maintain a portfolio duration of less than twelve months (1 year).⁵² The Adviser may adjust the Fund's duration within the stated limit based on current and anticipated changes in interest rates.

Additionally, under normal circumstances, the Fund generally expects to maintain a portfolio maturity (which is the weighted average maturity of all the securities held in the portfolio) of less than twenty-four months (2 years). For most security types, the security's final maturity date (the date on which the final principal payment of the security is scheduled to be paid) will be used to determine the Fund's portfolio maturity.⁵³ The Fund will not purchase any

⁴⁹ See note 13, supra.

⁵⁰ See note 14, supra.

⁵¹ See note 15, supra.

⁵² See note 16, supra.

⁵³ See note 17, supra.

security with a maturity – or, for securitized investments, a weighted average life – of more than thirty-six months (3 years) from the date of acquisition. The Adviser may adjust the Fund’s maturity within the stated limit based on current and anticipated changes in interest rates.

The Fund is an actively-managed fund that does not seek to track the performance of a specific index. The Exchange notes, however, that the Fund’s portfolio, under normal circumstances, will meet certain criteria similar to those applicable to index-based, fixed-income exchange-traded funds contained in NYSE Arca Equities Rule 5.2(j)(3), Commentary .02.⁵⁴

Non-Principal Investments⁵⁵

As part of each Fund’s non-principal investment strategies, a Fund may invest in other securities such as Build America Bonds;⁵⁶ capital and trust preferred securities;⁵⁷ fixed-income securities with put features; sinking funds⁵⁸; and zero-coupon, step-coupon, and pay-in-kind

⁵⁴ See note 18, supra.

⁵⁵ Certain investments have been identified as “Non-Principal Investments” within the Registration Statements given the limited extent to which these investments are expected to constitute each Fund’s portfolio. These non-principal investments, however, may be considered within a Fund’s 90% investment policy to the extent they are investment-grade short-term fixed-income securities.

⁵⁶ Build America Bonds offer an alternative form of financing to state and local governments whose primary means for accessing the capital markets has historically been through the issuance of tax-free municipal bonds. Issuance of Build America Bonds ceased on December 31, 2010. Outstanding Build America Bonds will continue to be eligible for the federal interest-rate subsidy, which continues for the life of the bonds.

⁵⁷ Capital securities are certain subordinated securities and generally rank senior to common stock and preferred stock in an issuer’s capital structure, but have a lower security claim than the issuer’s corporate bonds. Trust preferred securities have characteristics similar to other capital securities. They are issued by a special purpose trust subsidiary backed by subordinated debt of the corporate parent.

⁵⁸ Sinking funds are generally established by bond issuers to set aside a certain amount of money to cover timely repayment of bondholders’ principal raised through a bond issuance. By creating a sinking fund, the issuer is able to spread repayment of principal to numerous bondholders while reducing reliance on its then-current cash flows. A sinking fund also may allow the issuer to annually repurchase certain of its outstanding bonds from the open market or repurchase certain of its bonds at a call price named in a

securities.⁵⁹ Also as part of each Fund's non-principal investment strategies, a Fund may borrow money in accordance with the 1940 Act as outlined in a Fund's Registration Statement.

A Fund may not hold more than 15% of its net assets in illiquid assets, including Rule 144A securities⁶⁰ except for Rule 144A securities deemed liquid by the Adviser, based on criteria for liquidity established by the Board, consistent with Commission guidance.⁶¹ Each Fund will monitor its portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained and will consider taking appropriate steps in order to maintain adequate liquidity if, through a change in values, net assets, or other circumstances, more than 15% of a Fund's net assets are held in illiquid assets. Illiquid assets include securities subject to contractual or other restrictions on resale and other

bond's sinking fund provision. This call provision allows bonds to be prepaid or called prior to a bond's maturity.

⁵⁹ Zero-coupon, step-coupon, and pay-in-kind securities are fixed-income securities that do not make regular cash interest payments throughout the period prior to maturity. Zero-coupon and step-coupon securities are sold at a deep discount to their face value. A zero-coupon security pays no interest to its holders during its life. Step-coupon securities are debt securities that, instead of having a fixed coupon for the life of the security, have coupon or interest payments that may increase or decrease to pre-determined rates at future dates. Pay-in-kind securities pay interest through the issuance of additional securities. To continue to qualify as a "regulated investment company" or "RIC" under the Internal Revenue Code of 1986, as amended, and to avoid excise tax, each Fund may be required to distribute a portion of such discount value and income and may be required to dispose of other portfolio securities, which may occur in periods of adverse market prices, in order to generate cash to meet these distribution requirements.

⁶⁰ Rule 144A securities are securities that, while privately placed, are eligible for purchase and resale pursuant to Rule 144A of the Securities Act.

⁶¹ In reaching liquidity decisions, the Adviser may consider the following factors: the frequency of trades and quotes for the security; the number of dealers wishing to purchase or sell the security and the number of other potential purchasers; dealer undertakings to make a market in the security; and the nature of the security and the nature of the marketplace in which it trades (e.g., the time needed to dispose of the security, the method of soliciting offers and the mechanics of transfer).

instruments that lack readily available markets as determined in accordance with Commission staff guidance.

Furthermore, a Fund may not concentrate investments in a particular industry or group of industries, as concentration is defined under the 1940 Act, the rules or regulations thereunder, or any exemption therefrom, as such statute, rules, or regulations may be amended or interpreted from time to time.

Each Fund will not invest in options, futures, swaps, or other derivatives or in non-U.S. equity securities. A Fund's investments will be consistent with its investment objective and will not be used to enhance leverage.

Additional information regarding the Trust, the Funds, and the Shares of each Fund, including investment strategies, risks, creation and redemption procedures, fees, portfolio holdings, disclosure policies, distributions, and taxes, among other things, is included in the Notice and Registration Statements, as applicable.⁶²

III. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act⁶³ and the rules and regulations thereunder applicable to a national securities exchange.⁶⁴ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁶⁵ which requires, among other things, that the Exchange's rules be designed to prevent fraudulent and manipulative acts and

⁶² See Notice and Registration Statements, supra notes 3 and 4, respectively.

⁶³ 15 U.S.C. 78f.

⁶⁴ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁶⁵ 15 U.S.C. 78f(b)(5).

practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission notes that the Funds and the Shares must comply with the requirements of NYSE Arca Equities Rule 8.600 for the Shares to be listed and traded on the Exchange.

The Commission finds that the proposal to list and trade the Shares on the Exchange is consistent with Section 11A(a)(1)(C)(iii) of the Act,⁶⁶ which sets forth Congress’s finding that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the availability to brokers, dealers, and investors of information with respect to quotations for, and transactions in, securities. Quotation and last-sale information for the Shares will be available via the Consolidated Tape Association (“CTA”) high-speed line. In addition, the Portfolio Indicative Value, as defined in NYSE Arca Equities Rule 8.600(c)(3), of the Shares of each Fund will be widely disseminated by one or more major market data vendors at least every 15 seconds during the Core Trading Session.⁶⁷ On each day that the Exchange is open for business (normally from 9:30 a.m. until 4:00 p.m. Eastern Time) (“Business Day”), before commencement of the Core Trading Session, the Adviser will disclose on each Fund’s website the Disclosed Portfolio, as defined in NYSE Arca Equities Rule 8.600(c)(2), that will form the basis for each Fund’s calculation of net asset value (“NAV”) at the

⁶⁶ 15 U.S.C. 78k-1(a)(1)(C)(iii).

⁶⁷ According to the Exchange, several major market-data vendors widely disseminate PIVs taken from CTA or other data feeds. The Exchange further notes that the PIV’s approximate value generally will be determined by using current market quotations or price quotations obtained from broker-dealers that may trade in the portfolio securities held by a Fund. The PIV will be based upon the current value for the components of a Fund’s Disclosed Portfolio, as defined in NYSE Arca Equities Rule 8.600(c)(2).

end of the Business Day.⁶⁸ Each Fund will calculate its NAV at the close of the regular trading session of each Business Day using the values of the respective Fund's portfolio securities.⁶⁹ A basket composition file disclosing each Fund's securities, which will include the security names and share quantities required to be delivered in exchange for Fund Shares, together with estimates and actual cash components, will be publicly disseminated daily prior to the opening of the New York Stock Exchange via the National Securities Clearing Corporation. Information

⁶⁸ On a daily basis, the Adviser will disclose for each portfolio security and financial instrument of each Fund the following information: ticker symbol (if applicable); name of security and financial instrument; number of shares, if applicable, and dollar value of securities and financial instruments held in the portfolio; and percentage weighting of the security and financial instrument in the portfolio. The website information will be publicly available at no charge.

⁶⁹ The Exchange represents that, when valuing fixed-income securities with remaining maturities of more than 60 days, each Fund will use the value of the security provided by independent pricing services. The pricing services may value fixed-income securities at an evaluated price by employing methodologies that use actual market transactions, broker-supplied valuations, or other methodologies designed to identify the market value for such securities. When valuing fixed-income securities with remaining maturities of 60 days or less, each Fund may use the security's amortized cost, which approximates the security's market value. Corporate and commercial debt instruments; privately-issued securities; mortgage-backed and asset-backed securities; variable- and floating-rate fixed-income securities; repurchase agreements; money market instruments; obligations issued by the U.S. government or its agencies and instrumentalities; bank notes and similar demand deposits; Build America Bonds; fixed-income securities with put features; sinking funds; over-the-counter capital and trust-preferred securities; and step-coupons will be valued based on price quotations or other equivalent indications of value provided by a third-party pricing service. Any such third-party pricing service may use a variety of methodologies to value some or all of a Fund's debt securities to determine the market price. For example, the prices of securities with characteristics similar to those held by each Fund may be used to assist with the pricing process. In addition, the pricing service may use proprietary pricing models. A Fund's debt securities may be valued at the mean between the last available bid and ask prices for such securities or, if such prices are not available, at prices for securities of comparable maturity, quality, and type. Short-term securities for which market quotations are not readily available will be valued at amortized cost, which approximates market value. ETFs and exchange-traded capital and trust preferred securities will be valued at market value, which will generally be determined using the last reported official closing or last trading price on the exchange or market on which the security is primarily traded at the time of valuation. Investment company securities, including money market funds, (other than ETFs) will be valued at NAV.

regarding market price and trading volume of the Shares will be continually available on a real-time basis throughout the day on brokers' computer screens and other electronic services. Information regarding the previous day's closing price and trading volume information for the Shares will be published daily in the financial section of newspapers or will be available via the respective newspapers' websites and other such sources. Intra-day and closing price information regarding corporate and commercial debt instruments; privately-issued securities; mortgage-backed and asset-backed securities; variable- and floating-rate fixed-income securities; repurchase agreements; money market instruments; obligations issued by the U.S. government or its agencies and instrumentalities; bank notes and similar demand deposits; Build America Bonds; fixed-income securities with put features; sinking funds; capital and trust-preferred securities; and step-coupons will be available from major market data vendors. Price information for ETFs and exchange-traded capital and trust-preferred securities will be available from the applicable exchange or major market-data vendors. Price information for other investment company securities (including money market funds) will be available from major market-data vendors. The Funds' website will include a form of the prospectus for each Fund, which may be downloaded, and additional data relating to NAV and other applicable quantitative information.

The Commission further believes that the proposal to list and trade the Shares is reasonably designed to promote fair disclosure of information that may be necessary to price the Shares appropriately and to prevent trading when a reasonable degree of transparency cannot be assured. The Commission notes that the Exchange will obtain a representation from the issuer of the Shares of each Fund that the NAV per Share will be calculated daily and that the NAV and

the Disclosed Portfolio will be made available to all market participants at the same time.⁷⁰ The Exchange may halt trading in the Shares if trading is not occurring in the securities or the financial instruments constituting the Disclosed Portfolio of a Fund, or if other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.⁷¹ In addition, trading in the Shares will be subject to NYSE Arca Equities Rule 8.600(d)(2)(D), which sets forth circumstances under which Shares of each Fund may be halted. Further, the Commission notes that the Reporting Authority that provides the Disclosed Portfolio of each Fund must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material, non-public information regarding the actual components of the portfolio.⁷² The Commission further notes that the Financial Industry Regulatory Authority (“FINRA”), on behalf of the Exchange, will communicate as needed regarding trading in the Shares, ETFs, exchange-traded capital and trust-preferred securities, and other exchange-listed assets, as applicable, with other markets and other entities that are members of the Intermarket Surveillance Group (“ISG”), and FINRA, on behalf of the Exchange,⁷³ may obtain trading information regarding trading in the Shares, ETFs, exchange-traded capital and trust-preferred securities, and other exchange-listed assets, as applicable, from such markets and other

⁷⁰ See NYSE Arca Equities Rule 8.600(d)(1)(B).

⁷¹ See NYSE Arca Equities Rule 8.600(d)(2)(C) (providing additional considerations for the suspension of trading in or removal from listing of Managed Fund Shares on the Exchange). With respect to trading halts, the Exchange may consider all relevant factors in exercising its discretion to halt or suspend trading in the Shares of each Fund. Trading in Shares of either Fund will be halted if the circuit breaker parameters in NYSE Arca Equities Rule 7.12 have been reached. Trading also may be halted because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable.

⁷² See NYSE Arca Equities Rule 8.600(d)(2)(B)(ii).

⁷³ The Exchange states that, while FINRA surveils trading on the Exchange pursuant to a regulatory services agreement, the Exchange is responsible for FINRA’s performance under this regulatory services agreement.

entities. In addition, the Exchange may obtain information regarding trading in the Shares, ETFs, exchange-traded capital and trust-preferred securities, and other exchange-listed assets, as applicable, from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.⁷⁴ FINRA, on behalf of the Exchange, is able to access, as needed, trade information reported to FINRA's Trade Reporting and Compliance Engine ("TRACE") for certain fixed-income securities held by the Funds.

The Exchange states that it has a general policy prohibiting the distribution of material, non-public information by its employees. The Exchange also states that CSIM is not a broker-dealer but is affiliated with a broker-dealer, Charles Schwab & Co., Inc., and that CSIM has implemented and will maintain a fire wall with respect to its broker-dealer affiliate regarding access to information concerning the composition of or changes to the portfolios.⁷⁵

⁷⁴ For a list of the current members of ISG, see www.isgportal.org. The Exchange notes that not all components of the Disclosed Portfolio for each Fund may trade on markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.

⁷⁵ See *supra* note 5. An investment adviser to an open-end fund is required to be registered under the Investment Advisers Act of 1940 ("Advisers Act"). As a result, the Adviser and its related personnel are subject to the provisions of Rule 204A-1 under the Advisers Act relating to codes of ethics. This Rule requires investment advisers to adopt a code of ethics that reflects the fiduciary nature of the relationship to clients as well as compliance with other applicable securities laws. Accordingly, procedures designed to prevent the communication and misuse of non-public information by an investment adviser must be consistent with Rule 204A-1 under the Advisers Act. In addition, Rule 206(4)-7 under the Advisers Act makes it unlawful for an investment adviser to provide investment advice to clients unless such investment adviser has (i) adopted and implemented written policies and procedures reasonably designed to prevent violation, by the investment adviser and its supervised persons, of the Advisers Act and the Commission rules adopted thereunder; (ii) implemented, at a minimum, an annual review regarding the adequacy of the policies and procedures established pursuant to subparagraph (i) above and the effectiveness of their implementation; and (iii) designated an individual (who is a supervised person) responsible for administering the policies and procedures adopted under subparagraph (i) above.

The Exchange represents that the Shares are deemed to be equity securities, thus rendering trading in the Shares subject to the Exchange's existing rules governing the trading of equity securities. In support of this proposal, the Exchange has made representations, including:

- (1) The Shares of each Fund will conform to the initial and continued listing criteria under NYSE Arca Equities Rule 8.600.
- (2) The Exchange has appropriate rules to facilitate transactions in the Shares during all trading sessions.
- (3) The Exchange represents that trading in the Shares will be subject to the existing trading surveillances, administered by FINRA on behalf of the Exchange, that are designed to detect violations of Exchange rules and applicable federal securities laws and that these procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of Exchange rules and federal securities laws applicable to trading on the Exchange.
- (4) Prior to the commencement of trading, the Exchange will inform its Equity Trading Permit ("ETP") Holders in an Information Bulletin of the special characteristics and risks associated with trading the Shares. Specifically, the Information Bulletin will discuss the following: (a) the procedures for purchases and redemptions of Shares in Creation Units (and that Shares are not individually redeemable); (b) NYSE Arca Equities Rule 9.2(a), which imposes a duty of due diligence on its ETP Holders to learn the essential facts relating to every customer prior to trading the Shares; (c) the risks involved in trading the Shares during the Opening and Late Trading Sessions when an updated Portfolio Indicative Value will not be calculated or publicly disseminated; (d) how information regarding the

Portfolio Indicative Value is disseminated; (e) the requirement that ETP Holders deliver a prospectus to investors purchasing newly issued Shares prior to or concurrently with the confirmation of a transaction; and (f) trading information.

- (5) For initial and continued listing, each Fund will be in compliance with Rule 10A-3 under the Exchange Act,⁷⁶ as provided by NYSE Arca Equities Rule 5.3.
- (6) The Adviser expects that, under normal market circumstances, each Fund will generally seek to invest in corporate bond issuances in developed countries that have at least \$100,000,000 par amount outstanding and at least \$200,000,000 par amount outstanding with respect to corporate bond issuances in emerging market countries.
- (7) Each Fund's investments in each of the following security types will be limited to 10% of a Fund's net assets: (a) non-agency residential-mortgage-backed securities; (b) non-agency commercial-mortgage-backed securities; and (c) non-agency asset-backed securities. Each Fund's aggregate investments in the following security types will be limited to 20% of a Fund's net assets: (a) non-agency residential-mortgage-backed securities; (b) non-agency commercial-mortgage-backed securities; and (c) non-agency asset-backed securities.
- (8) At least 90% of a Fund's net assets will be, under normal circumstances, invested in U.S. dollar-denominated fixed-income securities. All fixed-income securities, including mortgage-backed and asset-backed securities, purchased by a Fund will be rated A- or higher. Neither high-yield asset-backed securities nor high-yield

⁷⁶ 17 CFR 240.10A-3.

mortgage-backed securities are included in a Fund's principal investment strategies.

- (9) Each Fund's portfolio, under normal circumstances, will meet certain criteria similar to those applicable to index-based, fixed-income exchange-traded funds contained in NYSE Arca Equities Rule 5.2(j)(3), Commentary.02.⁷⁷
- (10) A Fund may not hold more than 15% of its net assets in illiquid assets, including Rule 144A securities, except for Rule 144A securities deemed liquid by the Adviser, based on criteria for liquidity established by the Board, consistent with Commission guidance.
- (11) A minimum of 100,000 Shares of each Fund will be outstanding at the commencement of trading on the Exchange.
- (12) With respect to each of the Funds, the Fund's investments will be consistent with the Fund's investment objective and will not be used to enhance leverage. While each Fund may invest in inverse ETFs, a Fund will not invest in leveraged (e.g., 2X or 3X) or leveraged inverse ETFs.
- (13) Each Fund will not invest in options, futures, swaps, or other derivatives, or in non-U.S. equity securities.

This approval order is based on all of the Exchange's representations and description of the Funds, including those set forth above and in the Notice.

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act⁷⁸ and the rules and regulations thereunder applicable to a national securities exchange.

⁷⁷ See note 18, supra.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁷⁹ that the proposed rule change (SR-NYSEArca-2014-42) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸⁰

Kevin M. O'Neill
Deputy Secretary

[FR Doc. 2014-13564 Filed 06/10/2014 at 8:45 am; Publication Date: 06/11/2014]

⁷⁸ 15 U.S.C. 78f(b)(5).

⁷⁹ 15 U.S.C. 78s(b)(2).

⁸⁰ 17 CFR 200.30-3(a)(12).